



# UPMC Unaudited Quarterly Disclosure

FOR THE PERIOD ENDED MARCH 31, 2019

**UPMC**  
LIFE CHANGING MEDICINE

# UPMC Unaudited Quarterly Disclosure

FOR THE PERIOD ENDED MARCH 31, 2019

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The following financial data as of March 31, 2019 and for the three month periods ended March 31, 2019 and 2018 is derived from the interim consolidated financial statements of UPMC. The interim consolidated financial statements include all adjustments consisting of a normal recurring nature that UPMC considers necessary for a fair presentation of its financial position and the results of operations for these periods. The financial information as of December 31, 2018 is derived from UPMC's audited consolidated financial statements. Operating and financial results reported herein are not necessarily indicative of the results that may be expected for any future periods.

The information contained herein is being filed by UPMC for the purpose of complying with its obligations under Continuing Disclosure Agreements entered into in connection with the issuance of the series of bonds listed herein and disclosure and compliance obligations in connection with various banking arrangements. The information contained herein is as of March 31, 2019. Digital Assurance Certification, L.L.C., as Dissemination Agent, has not participated in the preparation of this Unaudited Quarterly Disclosure, has not examined its contents and makes no representations concerning the accuracy and completeness of the information contained herein.



# INTRODUCTION TO MANAGEMENT'S DISCUSSION AND ANALYSIS

PERIOD ENDED MARCH 31, 2019

UPMC, doing business as the University of Pittsburgh Medical Center, is one of the world's leading Integrated Delivery and Financing Systems ("IDFS"). UPMC is based in Pittsburgh, Pennsylvania and primarily serves residents across the Commonwealth of Pennsylvania. We also draw patients for highly specialized services from across the nation and around the world. UPMC's 40 hospitals and more than 700 clinical locations comprise one of the largest nonprofit health systems in the United States. UPMC has three major divisions: Health Services, Insurance Services, and UPMC Enterprises.

We are committed to providing the communities that our hospitals, outpatient centers and other health care facilities serve, as well as our insurance members, with high quality, cost-effective health care while continuing to grow our business and execute on our mission to provide Life Changing Medicine. As the stewards of UPMC's community assets, we are guided by our core values of integrity, excellence, respect and teamwork. These values govern the manner in which we serve our communities and are embedded in the execution and delivery of Life Changing Medicine.

UPMC continues to make significant investments in equipment, technology, education and operational strategies designed to improve clinical quality at our hospitals and outpatient centers. As a result of our efforts, UPMC Presbyterian Shadyside is consistently ranked on the *U.S. News & World Report* Honor Roll of America's Best Hospitals. Investments in our operations and continued capital improvements are expected to become increasingly important as the competitive environment of the market and changes to health care nationally continue to progress and change the landscape of patient care and reimbursement. We build new facilities, make strategic acquisitions, and enter into joint venture arrangements or affiliations with health care businesses — in each case in communities where we believe our mission can be effectively utilized to improve the overall health of those communities.

By continually evolving and refining UPMC's world-class financial processes, we focus on achieving optimal financial results that support the continued development of our organization, as well as ongoing investment in the future of Pennsylvania. We are committed to achieving these objectives with unyielding commitments to transparency in reporting and disclosure, enterprise-wide integration, and ongoing process improvement.

The purpose of this section, Management's Discussion and Analysis ("MD&A"), is to provide a narrative explanation of our financial statements that enhances our overall financial disclosures, to provide the context within which our financial information may be analyzed, and to provide information about the quality of, and potential variability of, our financial condition, results of operations and cash flows.

Unless otherwise indicated, all financial and statistical information included herein relates to our continuing operations, with dollar amounts expressed in thousands (except for statistical information). MD&A should be read in conjunction with the accompanying unaudited consolidated financial statements.

# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

## CONSOLIDATED FINANCIAL HIGHLIGHTS

(Dollars in millions)

Financial Results for the Three Months Ended March 31	2019	2018
Operating revenues	\$ 5,057	\$ 4,580
Operating income	\$ 51	\$ 92
Operating margin	1.0%	2.0%
Operating margin (including income tax and interest expense)	0.1%	1.0%
Gain from investing and financing activities	\$ 224	\$ 4
Excess of revenues over expenses	\$ 289	\$ 97
Operating EBIDA	\$ 206	\$ 245
Capital expenditures	\$ 235	\$ 214
Reinvestment ratio	1.52	1.40

Selected Other Information as of	March 31, 2019	December 31, 2018
Total cash and investments	\$ 7,254	\$ 6,856
Unrestricted cash and investments	\$ 5,479	\$ 5,098
Unrestricted cash and investments over long-term debt	\$ 1,243	\$ 1,059
Days of cash on hand	103	101
Days in net accounts receivable	43	39
Average age of plant	8.8	8.7

Operating revenues for the three months ended March 31, 2019 increased \$477 million, or 10%, as compared to the three months ended March 31, 2018. Operating income for the three months ended March 31, 2019 decreased \$41 million over the same period in the prior fiscal year. Operating earnings before interest, depreciation and amortization totaled \$206 million, and excess of revenues over expenses was \$289 million. As of March 31, 2019, UPMC had \$7.3 billion of cash and investments.

For the three months ended March 31, 2019:

- Hospital medical-surgical admissions and observation cases decreased 2% compared to the prior year.
- Hospital outpatient revenue per workday increased 8% compared to the prior year.
- Physician service revenue per weekday increased 9% from the comparable period in the prior year, and
- Enrollment in UPMC's Insurance Services grew to 3.5 million members as of March 31, 2019.

UPMC's gain from investing and financing activities, excluding UPMC Enterprises activity, for the three months ended March 31, 2019 was \$257 million. UPMC continues to have a long-term perspective with regard to its investment activities.

# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

## BUSINESS HIGHLIGHTS

On January 8, 2019, ISMETT, the UPMC-operated transplant hospital in Palermo, Italy, and the Region of Sicily signed a 10-year renewal of their longtime partnership for managing the facility. The agreement provides funding that will expand the number of beds in the hospital by almost 50 percent and affirms the region's support for a new hospital to be built in Sicily adjacent to the planned Biomedical Research and Biotechnology Center, both of which also will be operated by UPMC. The new Framework Agreement allocates an investment of €100 million per year from the Region of Sicily for the next 10 years. Under the agreement, the number of beds at ISMETT will increase from 78 to 114. At least 3 percent of the budget established by the region will be allocated to training for staff from other Sicilian clinical facilities. Founded in June 1997 by the Region of Sicily and UPMC, ISMETT was included in the regional health system in 2012 and two years later was designated as a government-approved research hospital, or Istituto di Ricovero e Cura a Carattere Scientifico. The designation acknowledges ISMETT for its excellence in research, training, quality of care and management of health services. The proposed hospital next to the Biomedical Research and Biotechnology Center in Carini will include 250 beds. The hospital and research center are expected to fuel scientific and medical excellence in southern Italy and will provide training, in collaboration with Sicilian universities, to health care professionals in various fields. Groundbreaking for the research center is expected later this year, with construction of the hospital expected to follow in 2020.

On February 1, 2019, Somerset Hospital in Somerset, Pa., affiliated with UPMC and became UPMC Somerset. The affiliation allows a greater opportunity for the Somerset facility to grow and offer more specialty services to local patients close to their homes. UPMC has committed to invest at least \$45 million over 10 years to enhance services and upgrade facilities at UPMC Somerset. Expanding clinical programs, establishing a multi-specialty consultation program, adding a new primary care center, recruiting and retaining outstanding medical staff and updating information technology capabilities are among the initial investment priorities. UPMC also has assumed responsibility for all of Somerset Hospital's outstanding liabilities, including its pension and benefit plan obligations.

In an extension of its long-time efforts to improve the health of the people of Kazakhstan, UPMC in February 2019 signed a new advisory agreement with Nazarbayev University ("NU"). The advisory agreement is helping NU fully integrate patient care, education and research at its hospitals and clinics, adapting UPMC's successful model in Pittsburgh. The multimillion-dollar agreement follows more than six years of cooperation between Pittsburgh and NU to advance patient care in Kazakhstan since UPMC signed its first agreement in Kazakhstan in 2012. While the focus of UPMC's advisory work with NU has shifted since that time, the two partners remain committed to delivering health outcomes comparable to the most developed countries in the world. The latest agreement is aimed at transforming University Medical Center's ("UMC") health system into Kazakhstan's first fully integrated academic medical center, one that is financially viable, actively engaged in research, and dedicated to training and educating medical staff. As part of that effort, UPMC will help NU to pilot several academic departments. UPMC also is helping UMC's leadership in Astana with strategic planning, education and training, collaborative clinical trials with the University of Pittsburgh and UPMC, hospital information systems, and cost tracking and management. Part of NU's integrated academic health care system, UMC was established in 2015 based on the former three National Medical Holding clinics – the Republic Diagnostic Center, the National Research Center for Maternal and Child Health and the Republican Children's Rehabilitation Center. All three have been accredited by the Joint Commission International. Nazarbayev University School of Medicine, which admitted its first group of medical students in 2015, is being developed in collaboration with the University of Pittsburgh School of Medicine, UPMC's academic partner.

# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

On March 1, 2019, UPMC Pinnacle Lancaster ceased to operate as an inpatient facility as UPMC Pinnacle finalized the transition of inpatient services from UPMC Pinnacle Lancaster to UPMC Pinnacle Lititz, a more modern acute care hospital seven miles away. This action is part of a comprehensive plan to ensure the continued availability of the high-quality clinical care expected of UPMC for Lancaster-area communities. UPMC Pinnacle maintains a strong outpatient presence in Lancaster for primary and specialty care services, while continuing to invest in centralizing inpatient services at the Lititz hospital, expanding current programs and introducing new services.

On March 14, 2019, UPMC broke ground on the new UPMC Vision and Rehabilitation Tower at UPMC Mercy, which is being designed for the many patients in the Pittsburgh region and beyond who need physical rehabilitation and those who have diseases of the eye or vision impairment. The facility, part of UPMC's investment in specialty care hospitals, is projected to open in late 2022 and will position UPMC at the global forefront of rehabilitation and ophthalmic research and care. Once constructed, the 410,000-square-foot tower will house nine stories of collaborative space for clinicians, researchers, educators and industry partners.

On March 28, 2019, the Western Maryland Health System ("WMHS") Board of Directors signed a non-binding letter of intent with UPMC to pursue an affiliation agreement that would integrate WMHS into the UPMC system. A full affiliation would offer Allegany County, Maryland and the surrounding areas access to enhanced healthcare services, leverage UPMC's clinical expertise and give the hospital system improved ability to recruit more top doctors to the area. Since February 2018, WMHS and UPMC have been working together successfully under a clinical affiliation. Both parties are engaged in additional due diligence, research, and discussions to work toward a definitive agreement. This process is subject to customary regulatory review and is targeted from completion by the end of 2019.

In March 2019, UPMC and Atlanta-based IBEX IT Business Experts, an African-American, woman-owned IT solutions and delivery firm, entered an agreement to create technology that aims to increase the use of diverse suppliers by UPMC and other health care companies that adopt this solution. The result of this collaboration is a user-friendly, web-based system built specifically for supplier diversity managers. The new tool not only registers and tracks diverse suppliers and spending with such vendors, but also makes it simple to search for suppliers by key characteristics—such as location, type of ownership, or products and services offered—and to automate such tasks as updating needed certifications. Founded in 2012, IBEX is on the *Inc. 5000* List of fastest growing companies. UPMC's supplier diversity program is designed to provide diverse businesses equal access to procurement opportunities. The program ensures that certified diverse businesses are provided the maximum opportunity to participate as partners and suppliers of goods and services to UPMC.



# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

## CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

Three Months Ended March 31, 2019

(in millions)

	Health Services	Insurance Services	Eliminations	Consolidated
<b>Revenues:</b>				
Net patient service revenue	\$ 2,721	\$ -	\$ (533)	\$ 2,188
Insurance enrollment revenue	-	2,472	-	2,472
Other revenue	270	171	(44)	397
<b>Total operating revenues</b>	<b>\$ 2,991</b>	<b>\$ 2,643</b>	<b>\$ (577)</b>	<b>\$ 5,057</b>
<b>Expenses:</b>				
Salaries, professional fees and benefits	\$ 1,680	\$ 106	\$ (7)	\$ 1,779
Insurance claims expense	-	2,233	(533)	1,700
Supplies, purchased services and general	1,201	208	(37)	1,372
Depreciation and amortization	148	7	-	155
<b>Total operating expenses</b>	<b>3,029</b>	<b>2,554</b>	<b>(577)</b>	<b>5,006</b>
<b>Operating income</b>	<b>\$ (38)</b>	<b>\$ 89</b>	<b>-</b>	<b>\$ 51</b>
<b>Operating margin %</b>	<b>(1.3%)</b>	<b>3.4%</b>	<b>-</b>	<b>1.0%</b>
<b>Operating margin % (including income tax and interest expense)</b>	<b>(2.5%)</b>	<b>3.1%</b>	<b>-</b>	<b>0.1%</b>
<b>Operating EBIDA</b>	<b>\$ 110</b>	<b>\$ 96</b>	<b>-</b>	<b>\$ 206</b>
<b>Operating EBIDA %</b>	<b>3.7%</b>	<b>3.6%</b>	<b>-</b>	<b>4.1%</b>

Three Months Ended March 31, 2018

(in millions)

<b>Revenues:</b>				
Net patient service revenue	\$ 2,614	\$ -	\$ (508)	\$ 2,106
Insurance enrollment revenue	-	2,129	-	2,129
Other revenue	238	122	(15)	345
<b>Total operating revenues</b>	<b>\$ 2,852</b>	<b>\$ 2,251</b>	<b>\$ (523)</b>	<b>\$ 4,580</b>
<b>Expenses:</b>				
Salaries, professional fees and benefits	\$ 1,567	\$ 89	\$ (4)	\$ 1,652
Insurance claims expense	-	1,904	(508)	1,396
Supplies, purchased services and general	1,129	169	(11)	1,287
Depreciation and amortization	147	6	-	153
<b>Total operating expenses</b>	<b>2,843</b>	<b>2,168</b>	<b>(523)</b>	<b>4,488</b>
<b>Operating income</b>	<b>\$ 9</b>	<b>\$ 83</b>	<b>-</b>	<b>\$ 92</b>
<b>Operating margin %</b>	<b>0.3%</b>	<b>3.7%</b>	<b>-</b>	<b>2.0%</b>
<b>Operating margin % (including income tax and interest expense)</b>	<b>(1.0%)</b>	<b>3.3%</b>	<b>-</b>	<b>1.0%</b>
<b>Operating EBIDA</b>	<b>\$ 156</b>	<b>\$ 89</b>	<b>-</b>	<b>\$ 245</b>
<b>Operating EBIDA %</b>	<b>5.5%</b>	<b>4.0%</b>	<b>-</b>	<b>5.3%</b>

# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

## Health Services

UPMC Health Services Division ("Health Services") includes a comprehensive array of clinical capabilities consisting of hospitals, specialty service lines (e.g., transplantation services, woman care, behavioral health, pediatrics, cancer care and rehabilitation services), contract services (emergency medicine, pharmacy and laboratory) and 4,900 employed physicians with associated practices. Also included within Health Services are supporting foundations and UPMC's captive insurance programs. Hospital activity is monitored in four distinct groups: (i) academic hospitals that provide a comprehensive array of clinical services that include the specialty service lines listed above and serve as the primary academic and teaching centers for UPMC and are located in Pittsburgh; (ii) community hospitals that provide core clinical services mainly to the suburban Pittsburgh, greater Erie, and the greater Altoona populations of Pennsylvania; (iii) regional hospitals that provide core clinical services to certain other areas of western and central Pennsylvania; and (iv) pre- and post-acute care capabilities that include: UPMC HomeCare, a network of home health services, and UPMC Senior Communities, the facilities of which provide a complete network of senior living capabilities in greater Pittsburgh and surrounding counties. Health Services also includes international ventures which aims to bring new revenue streams into UPMC's domestic operations. International ventures currently include ISMETT, a transplant and specialty surgery hospital in Palermo, Italy, that has performed more than 2,200 transplants since its founding in 1999, a hospital system located in Ireland, a contract to provide remote second-opinion pathology consultations for patients in China and Singapore, a national oncology treatment and research center in Kazakhstan, as well as the Advanced Radiosurgery Center of Excellence at San Pietro FBF Hospital in Rome.

Health Services revenues of \$3.0 billion increased \$139 million versus the prior year. Operating income decreased by \$47 million as the current year reflected higher pension expense, overall expense inflation and increased physician investment.

## Insurance Services

UPMC holds various interests in health care financing initiatives and network care delivery operations that have 3.5 million members as of March 31, 2019. UPMC Health Plan is a health maintenance organization ("HMO") offering coverage for commercial and Medicare members. UPMC for You is also an HMO, which is engaged in providing coverage to Medical Assistance & Medicare Special Needs Plan beneficiaries. UPMC Health Network offers preferred provider organization ("PPO") plan designs to serve Medicare beneficiaries. UPMC Health Options offers PPO plan designs to serve commercial beneficiaries. UPMC for Life is a Medicare product line offered by various companies within the Insurance Services division. UPMC Work Partners provides fully insured workers' compensation, and integrated workers' compensation and disability services to employers. Community Care Behavioral Health Organization ("Community Care") is a state-licensed HMO that manages the behavioral health services for Medical Assistance through mandatory managed care programs in Pennsylvania.

Insurance Services revenues of \$2.6 billion increased \$392 million versus the prior year, driven by membership growth of over 100,000. Operating income increased by \$6 million, driven by higher underwriting income related to the higher membership.

## UPMC Enterprises

UPMC Enterprises leverages UPMC's integrated delivery and financing system capabilities to generate new revenue streams. This is accomplished by fostering new ideas for improvement in the delivery of health care, pursuing commercialization opportunities of smart technologies and developing strategic partnerships with industry leaders. Leveraging UPMC's long-standing reputation for academic and research excellence, UPMC Enterprises also sponsors the translation of basic science conducted in a research setting to its commercial use in bedside clinical practice, application in medical laboratories, or use across emerging venues where medicine is delivered. These ventures both support UPMC's core mission and help to stimulate the economy of western Pennsylvania.

UPMC Enterprises manages a portfolio that includes various product development initiatives and numerous operating companies with commercially-available products and services directed toward the improvement of the delivery of health care. Unlike the Health Services and Insurance Services divisions, UPMC Enterprises' results are classified as investing and financing activity in the Statements of Operations and Changes in Net Assets, consistent with the long-term nature of developing and commercializing technology-enabled initiatives.



# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

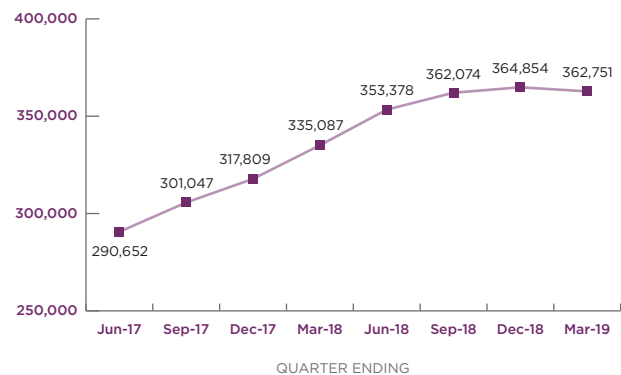
## REVENUE METRICS – HEALTH SERVICES

### Medical-Surgical Admissions and Observation Visits

Inpatient activity as measured by medical-surgical admissions and observation visits at UPMC's hospitals for the three months ended March 31, 2019 decreased 2% compared to the same period in 2018.

For the Three Months Ended March 31			
(in thousands)	2019	Change	2018
Academic	30.9	(4%)	32.3
Community	21.5	(3%)	22.2
Regional	37.2	0%	37.2
<b>Total</b>	<b>89.6</b>	<b>(2%)</b>	<b>91.7</b>

### Trailing Twelve-Months



### Outpatient Revenue per Workday

UPMC's outpatient activity for the three months ended March 31, 2019 as measured by average revenue per workday increased 8% compared to the same period in 2018. Hospital outpatient activity is measured on an equivalent workday ("EWD") basis to adjust for weekend and holiday hours.

For the Three Months Ended March 31			
(in thousands)	2019	Change	2018*
Academic	\$ 5,816	7%	\$ 5,411
Community	2,137	3%	2,078
Regional	6,545	11%	5,904
<b>Total</b>	<b>\$ 14,498</b>	<b>8%</b>	<b>\$ 13,393</b>

### Quarterly Average (in millions)



\* Adjustments to prior year methodology to conform to current year.

# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

## REVENUE METRICS – HEALTH SERVICES (CONTINUED)

### Physician Service Revenue per Weekday

UPMC's physician activity for the three months ended March 31, 2019 as measured by average revenue per weekday increased 9% from the comparable period in 2018. Physician services activity is measured on a weekday basis.

For the Three Months Ended March 31			
(in thousands)	2019	Change	2018
<b>Academic</b>	<b>\$ 3,623</b>	9%	\$ 3,326
<b>Community</b>	<b>1,704</b>	5%	1,622
<b>Regional</b>	<b>1,659</b>	12%	1,482
<b>Total</b>	<b>\$ 6,986</b>	9%	\$ 6,430

Quarterly Average (in millions)



### Sources of Patient Service Revenue

The gross patient service revenues, before explicit and implicit price concessions, of UPMC are derived from third-party payers which reimburse or pay UPMC for the services it provides to patients covered by such payers. Third-party payers include the federal Medicare Program, the federal and state Medical Assistance Program ("Medicaid"), Highmark Blue Cross Blue Shield ("Highmark") and other third-party insurers such as health maintenance organizations and preferred provider organizations. The following table is a summary of the percentage of the subsidiary hospitals' gross patient service revenue by payer.

	Three Months Ended March 31	
	2019	2018
<b>Medicare</b>	<b>48%</b>	46%
<b>Medicaid</b>	<b>17%</b>	18%
<b>UPMC Insurance Services Commercial</b>	<b>15%</b>	15%
<b>National Insurers Commercial</b>	<b>7%</b>	7%
<b>Highmark Commercial</b>	<b>6%</b>	7%
<b>Other</b>	<b>7%</b>	7%
<b>Total</b>	<b>100%</b>	100%

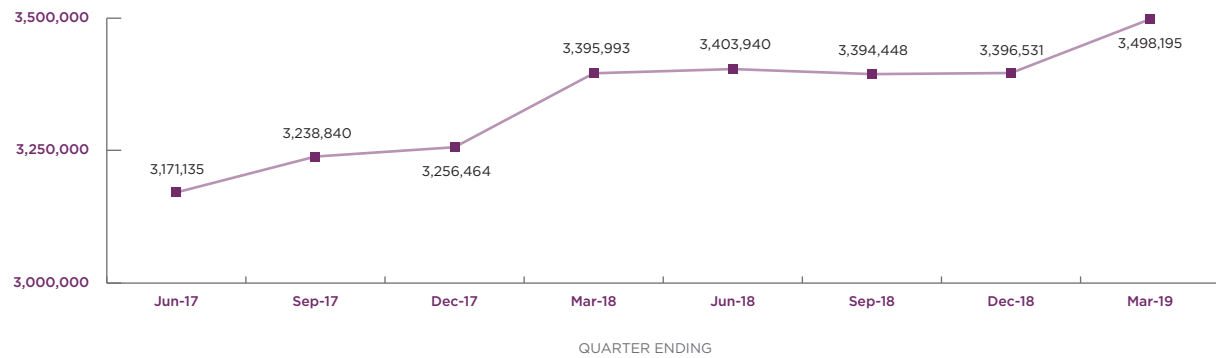
# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

## OPERATING METRICS - INSURANCE SERVICES

### Membership

Membership in the UPMC Insurance Services Division increased to 3,498,195 as of March 31, 2019, a 3% increase versus the same period in the prior year.

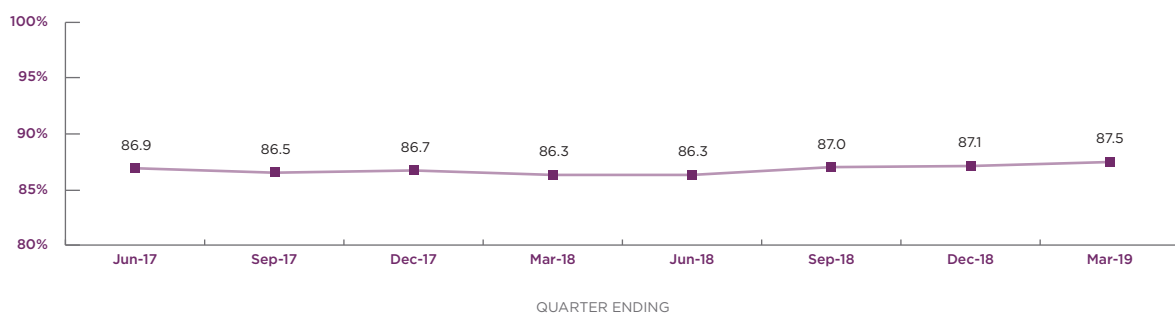


As of	Mar 31, 2019	Mar 31, 2018
Commercial Health	775,744	720,143
Medicare	190,745	176,656
Medicaid	421,493	425,228
Sub-Total Physical Health Products	1,387,982	1,322,027
Community HealthChoices	73,371	42,517
Behavioral Health	985,133	1,005,357
Sub-Total Health Products	2,446,486	2,369,901
Work Partners and Life Solutions	571,646	535,455
Ancillary Products	394,961	379,326
Evolent	85,102	111,311
<b>Total Membership</b>	<b>3,498,195</b>	<b>3,395,993</b>

### Healthcare Spending Ratio

UPMC Insurance Services Medical Expense Ratio remained stable as medical expenses trended consistently with premiums.

#### Trailing Twelve-Months



# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

## KEY FINANCIAL INDICATORS

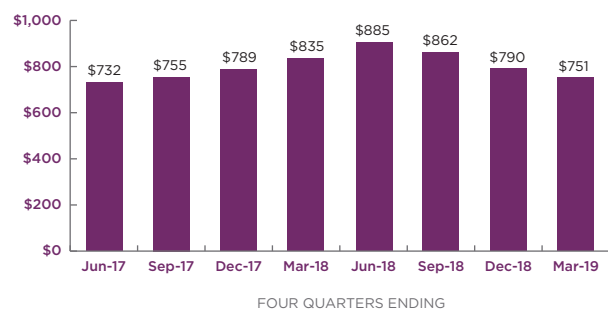
(Dollars in millions)

### Operating Earnings before Interest, Depreciation and Amortization

Operating EBIDA for the three months ended March 31, 2019 decreased 16% as compared to the three months ended March 31, 2018, as higher income from the Insurance Services division was more than offset by results from the Health Services division.

For the Three Months Ended March 31			
	2019	Change	2018
Operating Income	\$ 51	(45%)	\$ 92
Depreciation and Amortization	155	1%	153
Operating EBIDA	\$ 206	(16%)	\$ 245

### Trailing Twelve Months EBIDA



### Unrestricted Cash and Investments Over Long Term Debt

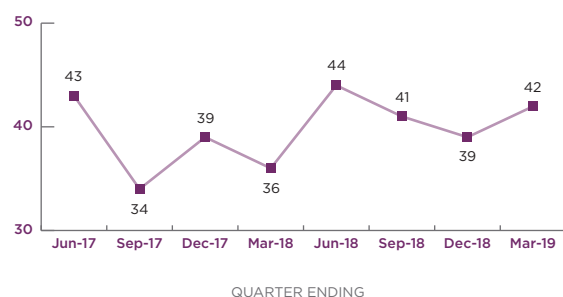
Unrestricted cash over long term debt increased by \$184 million as compared to December 2018.



### Days in Net Accounts Receivable

Consolidated Days in Accounts Receivable continue to be lower than industry averages due to UPMC's rigorous procedures in this area. Days in Accounts Receivable fluctuations are typically driven by the timing of payment from the state of Pennsylvania's Medicaid program.

By Receivable	2019 Balance	Days	
		Mar 31, 2019	Dec 31, 2018
Patient AR	\$ 1,128	46	42
Other AR	1,252	39	39
Consolidated	\$ 2,380	42	39



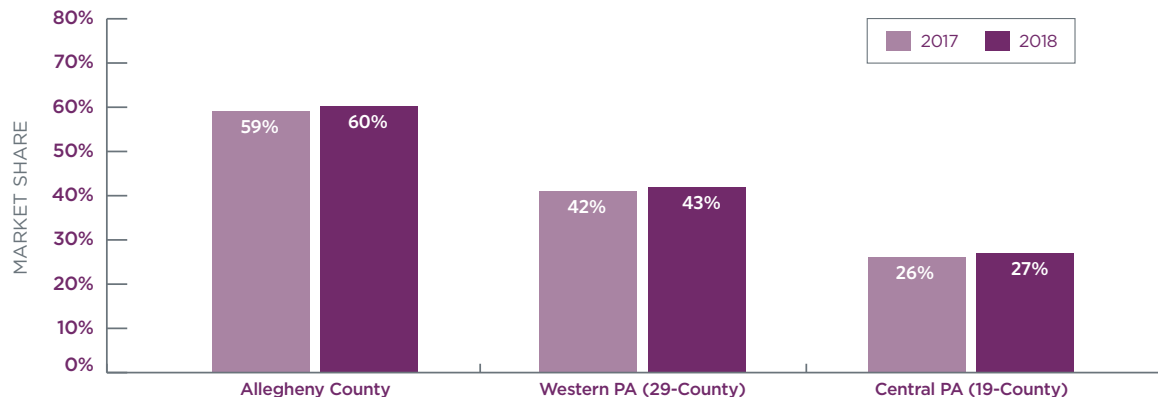
# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

## Market Share

The chart below shows the change in UPMC's estimated inpatient market share for the first three quarters of calendar years 2017 and 2018 by service area<sup>(1)</sup>. This is the most recent market share data currently available.

### UPMC INPATIENT MEDICAL-SURGICAL MARKET SHARE AS OF SEPTEMBER 30<sup>(2)</sup>



<sup>(1)</sup> UPMC's three service areas are (1) Allegheny County, (2) a 29-county region including Allegheny, Armstrong, Beaver, Bedford, Blair, Butler, Cambria, Cameron, Centre, Clarion, Clearfield, Crawford, Elk, Erie, Fayette, Forest, Greene, Huntingdon, Indiana, Jefferson, Lawrence, McKean, Mercer, Potter, Somerset, Venango, Warren, Washington, and Westmoreland counties., (3) a 19-county region including Adams, Clinton, Columbia, Cumberland, Dauphin, Franklin, Fulton, Juniata, Lancaster, Lebanon, Lycoming, Mifflin, Montour, Northumberland, Perry, Snyder, Tioga, Union, and York counties.

<sup>(2)</sup> Excludes psychiatry and substance abuse discharges.

# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

## ASSET AND LIABILITY MANAGEMENT

During the three months ended March 31, 2019, UPMC's investment portfolio returned 5.8%. As of March 31, 2019, UPMC utilized 141 ongoing external investment managers including 49 traditional managers, nine hedge fund managers and 83 private capital managers. UPMC is also invested with an additional 85 legacy private capital and hedge fund managers. UPMC's investment portfolio has a long-term perspective and has generated annualized returns of 3.1%, 7.8% and 5.8% for the trailing one-, three- and five-year periods. As of March 31, 2019, 67% of UPMC's investment portfolio could be liquidated within three days.

UPMC's annualized cost of capital during the period was 3.41%. This cost of capital includes the accrual of interest payments, the amortization of financing costs and original issue discount or premium, the ongoing costs of variable rate debt and the cash flow impact of derivative contracts. As of March 31, 2019, the interest rates on UPMC's long-term debt were approximately 70% fixed and 30% variable after giving effect to derivative contracts. Annualized interest cost for the variable rate debt for the period averaged 2.41%. The annualized interest cost for the fixed rate debt was 3.75%. UPMC's primary credit facility, which expires in January 2024, has a borrowing limit of \$600 million. As of March 31, 2019, UPMC had approximately \$79 million in letters of credit outstanding under the credit facility leaving \$521 million available to fund operating and capital needs, of which \$190 million was drawn.

UPMC has credit facilities of \$19 million (increased to \$150 million from May 15 to August 14 on an annual basis) and \$50 million with expiration dates in April 2022. Both of these credit facilities support the Insurance Services Division. As of March 31, 2019, there were no draws on either credit facility.

The table below compares reported Investing and Financing Activity for the three months ended March 31, 2019 and 2018 by type.

### Investing and Financing Activity by Type

Three Months Ended March 31	2019	2018
<i>(in thousands)</i>		
Realized gains	\$ 99,252	\$ 65,638
Interest and dividends, net of fees	20,650	22,684
Realized investment revenue	\$ 119,902	\$ 88,322
Unrealized gains (losses) on derivative contracts	1,494	(116)
Other unrealized gains (losses)	176,238	(43,092)
Investment revenue	\$ 297,634	\$ 45,114
Interest expense	(40,874)	(41,386)
UPMC Enterprises activity	(32,512)	244
<b>Gain from investing and financing activities</b>	<b>\$ 224,248</b>	<b>\$ 3,972</b>



# MANAGEMENT'S DISCUSSION & ANALYSIS

PERIOD ENDED MARCH 31, 2019

## Sources and Uses of Cash

UPMC's primary source of operating cash is the collection of revenues and related accounts receivable. As of March 31, 2019, UPMC had approximately \$392 million of cash and cash equivalents on hand to fund operations and capital expenditures, and borrowing availability under the primary credit facility was \$521 million to fund operating and capital needs, of which \$190 million was drawn.

Operating EBIDA was \$206 million for the three months ended March 31, 2019, compared to \$245 million for the three months ended March 31, 2018. Net cash provided by operating activities decreased to \$147 million in the three months ended March 31, 2019 compared to \$641 million provided by operating activities in the three months ended March 31, 2018.

Key sources and uses of cash from investing activities for the three month period ended March 31, 2019 include capital expenditures of \$235 million, as well as \$10 million to acquire ownership interests in and fund businesses. Major capital projects included construction and improvements at UPMC Pinnacle, UPMC Hamot and UPMC Mercy as well as ongoing expansion and improvement across the entirety of UPMC. Major information services projects included enhancements that are advancing UPMC's leading clinician centric computing environment, technology infrastructure that supports UPMC's diversified digital environment, investments in enterprise data analytics and other technologies that are transforming the consumer experience across the spectrum of health care.

# UTILIZATION STATISTICS

PERIOD ENDED MARCH 31, 2019

The following table presents selected consolidated statistical indicators of medical-surgical, psychiatric, sub-acute and rehabilitation patient activity for the three months ended March 31, 2019 and 2018.

	Three Months Ended March 31	
	2019	2018
Licensed Beds	8,496	8,641
<b>BEDS IN SERVICE</b>		
Medical-Surgical	4,767	4,819
Psychiatric	418	434
Rehabilitation	256	262
Skilled Nursing	1,430	1,392
Total Beds in Service	6,871	6,907
<b>PATIENT DAYS</b>		
Medical-Surgical	329,447	337,137
Psychiatric	31,964	35,584
Rehabilitation	19,690	20,129
Skilled Nursing	110,834	110,770
Total Patient Days	491,935	503,620
Average Daily Census	5,466	5,596
Observation Days	36,774	33,717
Obs Average Daily Census	409	375
<b>ADMISSIONS AND OBSERVATION CASES</b>		
Medical-Surgical	65,405	67,864
Observation Cases	24,174	23,818
Subtotal	89,579	91,682
Psychiatric	3,035	3,048
Rehabilitation	1,290	1,384
Skilled Nursing	1,237	1,338
Total Admissions and Observation Cases	95,141	97,452
Overall Occupancy	85%	86%
<b>AVERAGE LENGTH OF STAY</b>		
Medical-Surgical	5.0	5.0
Psychiatric	10.5	11.7
Rehabilitation	15.3	14.5
Skilled Nursing	89.6	82.8
Overall Average Length of Stay	6.9	6.8
Emergency Room Visits	274,996	286,147
<b>TRANSPLANTS (DOMESTIC)</b>		
Liver	29	28
Kidney	60	63
All Other	83	76
Total	172	167
<b>OTHER POST-ACUTE METRICS</b>		
Home Health Visits	200,887	185,406
Hospice Care Days	63,258	50,442
Outpatient Rehab Visits (CRS)	159,175	161,274

# OUTSTANDING DEBT

PERIOD ENDED MARCH 31, 2019

(IN THOUSANDS)

Issuer	Original Borrower	Series	Amount Outstanding
Allegheny County Hospital Development Authority	UPMC Health System	1997B	\$ 43,565
	UPMC	2007A	60,364
	UPMC	2007B	64,643
	UPMC	2008 Notes	77,935
	UPMC	2009A	316,108
	UPMC	2010A	81,581
	UPMC	2010B	98,130
	UPMC	2010C	50,000
	UPMC	2010D	150,000
	UPMC	2010F	95,000
	UPMC	2011A	77,872
	UPMC	2017D	499,649
Monroeville Finance Authority	UPMC	2012	321,773
	UPMC	2013B	60,280
	UPMC	2014B	47,506
	UPMC	2015A Note	66,047
Pennsylvania Economic Development Financing Authority	UPMC	2013A	114,747
	UPMC	2014A	295,256
	UPMC	2015B	122,283
	UPMC	2016	251,817
	UPMC	2017A	454,715
	UPMC	2017C	134,562
Erie County Hospital Authority	Hamot Health Foundation	2010A	9,874
	Hamot Health Foundation	2010C	500
Pennsylvania Higher Educational Facilities Authority	UPMC	2010E	210,120
Lycoming County Authority	Susquehanna Health System	2009	141,753
	The Williamsport Hospital	2011	14,306
Tioga County Industrial Development Authority	Laurel Health System	2010	7,320
	Laurel Health System	2011	5,676
Dauphin County General Authority	Pinnacle Health System	2009A	55,108
	Pinnacle Health System	2012A	137,092
	Pinnacle Health System	2016A	107,935
	Pinnacle Health System	2016B	89,255
General Authority of Southcentral Pennsylvania	Hanover Hospital	2013	9,911
	Hanover Hospital	2015	24,025
Potter County Hospital Authority	UPMC	2018A	22,993
Somerset County Hospital Authority	Somerset Hospital	2009A	1,438
	Somerset Hospital	2015A	18,000
None	UPMC	2011B	99,657
	UPMC	2017B	97,315
	UPMC	2018B	455
	Susquehanna Health Innovation Center	New Market Tax Credit	17,124
	Hanover Hospital	ACNB Note	112
	Somerset Hospital	2013	1,751
	UPMC	Swap Liabilities	6,193
	Various - Financing Leases and Loans		118,286
<b>Total</b>			<b>\$ 4,680,032</b>

Includes original issue discount and premium, Deferred Financing Costs, and other.

Source: UPMC Records

# DEBT COVENANT CALCULATIONS

PERIOD ENDED MARCH 31, 2019

## DEBT SERVICE COVERAGE RATIO

(Dollars in Thousands)

	Trailing Twelve-Month Period Ended March 31, 2019
Net Income	\$ (98,931)
<b>ADJUSTED BY:</b>	
Net Unrealized Losses from Period <sup>1</sup>	210,291
Depreciation and Amortization <sup>1</sup>	627,122
Inherent Contribution <sup>1</sup>	61,679
Realized Investment Impairments <sup>2</sup>	(29,344)
Interest Expense	159,680
Revenues Available for Debt Service	\$ 930,497
Historical Debt Service Requirements – 2007 MTI	\$ 358,776
Debt Service Coverage Ratio – 2007 MTI	2.59X
Historical Debt Service Requirements – All Debt and Financing Leases	\$ 392,698
Debt Service Coverage Ratio – All Debt and Financing Leases	2.37X

## LIQUIDITY RATIO AS OF MARCH 31, 2019

Unrestricted Cash and Investments	\$ 5,479,422
Master Trust Indenture Debt	\$ 4,416,973
<b>Unrestricted Cash to MTI Debt</b>	<b>1.24</b>

<sup>(1)</sup> Non-Cash.

<sup>(2)</sup> Reflects ultimate realization of previously impaired cost-based investments.

I hereby certify to the best of my knowledge that, as of March 31, 2019, UPMC is in compliance with the applicable covenants contained in the financing documents for the bonds listed on the cover hereof and all applicable bank lines of credit and no Event of Default (as defined in any related financing document) has occurred and is continuing.



C. Talbot Heppenstall, Jr.  
Treasurer  
UPMC

# Unaudited Interim Condensed Consolidated Financial Statements

FOR THE PERIOD ENDED MARCH 31, 2019

# REVIEW REPORT OF INDEPENDENT AUDITORS

The Board of Directors  
UPMC  
Pittsburgh, Pennsylvania

We have reviewed the condensed consolidated financial information of UPMC, which comprise the condensed consolidated balance sheet as of March 31, 2019, and the related condensed consolidated statements of operations and changes in net assets and cash flows for the three-month periods ended March 31, 2019 and 2018.

## Management's Responsibility for the Financial Information

Management is responsible for the preparation and fair presentation of the condensed financial information in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in conformity with U.S. generally accepted accounting principles.

## Auditor's Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

## Conclusion

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial information referred to above for it to be in conformity with U.S. generally accepted accounting principles.

## Report on Condensed Consolidated Balance Sheet as of December 31, 2018

We have previously audited, in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of UPMC as of December 31, 2018, and the related consolidated statements of operations and changes in net assets and cash flows for the year then ended (not presented herein); and we expressed an unqualified audit opinion on those audited consolidated financial statements in our report dated February 26, 2019. In our opinion, the accompanying condensed consolidated balance sheet of UPMC as of December 31, 2018, is consistent, in all material respects, with the consolidated balance sheet from which it has been derived.



Pittsburgh, Pennsylvania  
May 2, 2019



# CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(IN THOUSANDS)

	March 31 2019	As of December 31 2018
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 391,865	\$ 277,324
Patient accounts receivable	1,128,372	1,060,365
Other receivables	1,251,712	1,076,317
Securities lending collateral	52,242	171,657
Other current assets	361,233	358,100
Total current assets	3,185,424	2,943,763
Board-designated, restricted, trustee and other investments	6,861,848	6,578,930
Beneficial interests in foundations and trusts	499,726	499,957
Net property, buildings and equipment	5,423,103	5,334,051
Operating lease right-of-use assets	1,069,904	-
Other assets	480,495	482,246
Total assets	\$ 17,520,500	\$ 15,838,947
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued expenses	\$ 615,578	\$ 604,186
Accrued salaries and related benefits	837,112	720,756
Current portion of insurance reserves	696,686	636,566
Payable under securities lending agreement	52,242	171,657
Current portion of long-term obligations	462,273	462,147
Other current liabilities	729,928	472,059
Total current liabilities	3,393,819	3,067,371
Long-term obligations	4,217,759	4,245,409
Pension liability	146,746	114,178
Long-term insurance reserves	346,938	335,527
Operating lease noncurrent liabilities	1,012,372	-
Other noncurrent liabilities	376,437	341,407
Total liabilities	9,494,071	8,103,892
Net assets without donor restrictions	6,961,465	6,678,826
Net assets with donor restrictions	1,064,964	1,056,229
Total net assets	8,026,429	7,735,055
Total liabilities and net assets	\$ 17,520,500	\$ 15,838,947

See accompanying notes

# CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS (UNAUDITED)

(IN THOUSANDS)

	Three Months Ended Mar 31	
	2019	2018
<b>NET ASSETS WITHOUT DONOR RESTRICTIONS</b>		
Net patient service revenue	\$ 2,188,353	\$ 2,106,397
Insurance enrollment revenue	2,471,548	2,128,865
Other revenue	396,674	344,576
Total operating revenues	5,056,575	4,579,838
Expenses:		
Salaries, professional fees and employee benefits	1,778,480	1,651,967
Insurance claims expense	1,699,842	1,395,524
Supplies, purchased services and general	1,372,080	1,287,674
Depreciation and amortization	155,669	152,935
Total operating expenses	5,006,071	4,488,100
Operating income	50,504	91,738
Inherent contribution	16,666	5,990
Income tax expense	(2,659)	(4,280)
After-tax income	\$ 64,511	\$ 93,448
Investing and financing activities:		
Investment revenue	297,634	45,114
Interest expense	(40,874)	(41,386)
UPMC Enterprises activity:		
Portfolio company revenue	16,856	34,751
Portfolio company and development expense	(49,368)	(34,507)
Gain from investing and financing activities	224,248	3,972
Excess of revenues over expenses	288,759	97,420
Other changes in net assets without donor restrictions	(6,120)	23,818
Change in net assets without donor restrictions	282,639	121,238
<b>NET ASSETS WITH DONOR RESTRICTIONS</b>		
Contributions and other changes	6,157	858
Net realized and unrealized gains on restricted investments	6,207	12,738
Restricted net assets acquired	1,525	-
Assets released from restriction for operations and capital purchases	(4,923)	(10,968)
Change in beneficial interests in foundations and trusts	(231)	6,384
Change in net assets with donor restrictions	8,735	9,012
Change in net assets	291,374	130,250
Cumulative effect of change in accounting principle	-	218,800
Net assets, beginning of period	7,735,055	7,925,116
Net assets, end of period	\$ 8,026,429	\$ 8,274,166

See accompanying notes

# CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(IN THOUSANDS)

	Three Months Ended March 31	
	2019	2018
<b>OPERATING ACTIVITIES</b>		
Change in total net assets	\$ 291,374	\$ 130,250
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	155,669	152,935
Change in beneficial interest in foundations and trusts	231	(6,384)
Restricted contributions and investment revenue	(12,364)	(13,596)
Restricted net assets acquired through affiliations	(1,525)	-
Unrealized (gains) losses on investments	(176,238)	43,092
Realized gains on investments	(99,252)	(65,638)
Net change in non-alternative investments	(13,924)	73,607
Inherent contribution	(16,666)	(5,990)
Changes in operating assets and liabilities:		
Accounts receivable	(235,402)	(54,892)
Other current assets	120,121	(18,225)
Accounts payable and accrued liabilities	104,968	15,962
Insurance reserves	71,531	80,080
Other current liabilities	(51,546)	275,739
Other noncurrent assets and liabilities	(15,914)	34,375
Other operating changes	25,852	(707)
Net cash provided by operating activities	146,915	640,608
<b>INVESTING ACTIVITIES</b>		
Purchase of property and equipment (net of disposals)	(232,694)	(214,405)
UPMC Enterprises investments in joint ventures	(10,000)	(8,000)
Cash acquired through affiliations	21,272	-
Net change in investments designated as nontrading	(14,847)	(9,478)
Net change in alternative investments	29,837	(17,148)
Net change in other assets	17,641	22,140
Net cash used in investing activities	(188,791)	(226,891)
<b>FINANCING ACTIVITIES</b>		
Repayments of long-term obligations	(47,704)	(44,830)
Borrowings of long-term obligations	191,757	26,016
Restricted contributions and investment income	12,364	13,596
Net cash provided by (used in) financing activities	156,417	(5,218)
Net change in cash and cash equivalents	114,541	408,499
Cash and cash equivalents, beginning of period	277,324	529,631
Cash and cash equivalents, end of period	\$ 391,865	\$ 938,130
<b>SUPPLEMENTAL INFORMATION</b>		
Finance lease obligations incurred to acquire assets	\$ 2,739	\$ -

# NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

## 1. BASIS OF PRESENTATION

UPMC is a Pennsylvania nonprofit corporation and is exempt from federal income tax pursuant to Section 501(a) of the Internal Revenue Code (the "Code") as an organization described in Section 501(c)(3) of the Code. Headquartered in Pittsburgh, Pennsylvania, UPMC is one of the world's leading integrated delivery and financing systems. UPMC comprises nonprofit and for-profit entities offering medical and health-care-related services, including health insurance products. Closely affiliated with the University of Pittsburgh ("University") and with shared academic and research objectives, UPMC partners with the University's Schools of the Health Sciences to deliver outstanding patient care, train tomorrow's health care specialists and biomedical scientists, and conduct groundbreaking research on the causes and course of disease.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal and recurring nature. The accompanying unaudited interim condensed consolidated financial statements include the accounts of UPMC and its subsidiaries. Intercompany accounts and transactions are eliminated in consolidation. For further information, refer to the audited consolidated financial statements and notes thereto as of and for the twelve month period ended December 31, 2018.

## 2. NEW ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which consists of a comprehensive lease accounting standard. Under the new standard, assets and liabilities arising from most leases will be recognized on the balance sheet and enhanced disclosures on key quantitative and qualitative information about leasing arrangements will be required. Leases will be classified as either operating or financing, and the lease classification will determine whether expense is recognized on a straight-line basis (operating leases) or based on an effective interest method (financing leases). The new standard was effective for interim and annual periods on January 1, 2019, and UPMC has applied the transitional package of practical expedients allowed by the standard relating to the identification, classification and initial direct costs of leases commencing before the effective date; however, UPMC did not elect the hindsight transitional practical expedient. UPMC has made an accounting policy election to not apply recognition requirements of the guidance to short-term leases. In July 2018, the FASB issued ASU No. 2018-11, *Leases: Targeted Improvements*, which provides an optional transition method that allows entities to initially apply the new lease standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption while comparative periods presented will continue to be in accordance with current ASC 840. UPMC is using the optional transition method to apply the lease standard as of January 1, 2019. After adoption, UPMC recognized assets and liabilities of approximately \$1,200,000 as of the transition date. Refer to footnote 8 for additional disclosures.

In March 2017, the FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This new guidance requires the disaggregation of the service cost component from the other components of net benefit cost. The service cost component of net benefit cost is to be reported in the same line item on the consolidated statement of operations as other compensation costs arising from services rendered by the pertinent employees, while the other components of net benefit cost are to be presented in the consolidated statement of operations separately, outside a subtotal of operating income. The amendments also provide explicit guidance to allow only the service cost component of net benefit cost to be eligible for capitalization. The adoption of the change in presentation of net benefit cost in the consolidated statement of operations is to be applied retrospectively, and the change in capitalization for only service cost applied prospectively. The guidance allows a practical expedient that permits the use of the amounts disclosed in the retirement benefits footnote for the prior comparative periods as the estimation basis for applying the retrospective presentation requirements. UPMC will adopt for the year ending December 31, 2019 and interim periods in the subsequent year. The impact of adopting ASU 2017-07, when applied retrospectively

# NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

to the three months ended March 31, 2019, will increase salaries, professional fees and employee benefits on the consolidated statements of operations and changes in net assets presented herein by \$6,709, with a corresponding decrease to operating income and increase to other non-operating gains. As a result, for the three months ended March 31, 2019, operating income will be \$43,795 and other non-operating gains will be \$6,709 upon retrospective adoption of ASU 2017-07. The adoption will have no impact on excess of revenues over expenses or net assets.

## 3. REVENUE

### Net Patient Service Revenue

UPMC's net patient service revenue is reported at the amount that reflects the consideration to which UPMC expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payers (including health insurers and government programs), and others and include an estimate of variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, UPMC bills the patients and third-party payers several days after the services are performed and/or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied. Performance obligations are determined based on the nature of the services provided by UPMC. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. UPMC believes that this method provides a reasonable representation of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to inpatient services. UPMC measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided and UPMC does not believe it is required to provide additional goods or services to the patient.

The majority of UPMC's services are rendered to patients with third party coverage. Reimbursement under these programs for all payers is based on a combination of prospectively determined rates, discounted charges and historical costs. Amounts received under Medicare and Medical Assistance programs are subject to review and final determination by program intermediaries or their agents and the contracts UPMC has with commercial payers also provide for retroactive audit and review of claims. Agreements with third-party payers typically provide for payments at amounts less than established charges. Generally patients who are covered by third-party payers are responsible for related deductibles and coinsurance, which vary in amount. UPMC also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. UPMC estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change and are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Adjustments arising from a change in the transaction price were not significant in the three months ended March 31, 2019 or 2018.

Consistent with UPMC's mission, care is provided to patients regardless of their ability to pay. UPMC has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts UPMC expects to collect based on its collection history with those patients. Patients who meet UPMC's criteria for charity care are provided care without charge or at amounts less than established rates and UPMC has determined it has provided an implicit price concession. Price concessions including charity care are not reported as revenue.

# NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

The composition of net patient service revenue for the three months ended March 31, 2019 and 2018, primarily resulting from patients in the western Pennsylvania region, are as follows:

Three Months Ended March 31	2019	2018
Medicare	41%	39%
Commercial	36%	38%
Medicaid	15%	15%
Self-pay/other	8%	8%
	100%	100%

Laws and regulations governing the Medicare and Medical Assistance programs are extremely complex and subject to interpretation. Compliance with such laws and regulations is subject to government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from Medicare and Medical Assistance programs. As a result, there is at least a reasonable possibility that the recorded estimates may change.

## Insurance Enrollment Revenue

UPMC's insurance subsidiaries (collectively, "Health Plans") provide health care services on a prepaid basis under various contracts. Insurance enrollment revenues are recognized as income in the period in which enrollees are entitled to receive health care services, which represents the performance obligation. Health care premium payments received from UPMC's members in advance of the service period are recorded as unearned revenues.

Insurance enrollment revenues include commercial, Medicare, Medicaid and behavioral health contracts. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. UPMC believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the programs. As a result, there is at least a reasonable possibility that recorded estimates will change.

## Other Revenue

UPMC's other revenue consists of various contracts related to its Health Services and Insurance Services divisions. These contracts vary in duration and in performance obligations. In evaluating these contracts for compliance with ASU 2014-09, there were no changes to the nature, timing or extent of revenues previously recognized or how revenues are recognized prospectively. Revenues are recognized when the performance obligations identified within the individual contracts are satisfied and collections can be reasonably assured.

## 4. FAIR VALUE MEASUREMENTS

As of March 31, 2019, UPMC held certain assets that are required to be measured at fair value on a recurring basis. These include cash and cash equivalents and certain board-designated, restricted, trustee, and other investments and derivative instruments. Certain of UPMC's alternative investments are measured using either the cost or equity method of accounting and are therefore excluded from the fair value hierarchy tables presented herein. The valuation techniques used to measure fair value are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs are generally unsupported by market activity. The three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value, includes:

- Level 1: Quoted prices for identical assets or liabilities in active markets.
- Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-driven valuations whose inputs are observable or whose significant value drivers are observable.
- Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.



# NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

The following tables represent UPMC's fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis as of March 31, 2019 and December 31, 2018. The interest rate swaps are valued using internal models, which are primarily based on market observable inputs including interest rate curves. When quoted market prices are unobservable for fixed income securities, quotes from independent pricing vendors based on recent trading activity and other relevant information including market interest rate curves, referenced credit spreads and estimated prepayment rates where applicable are used for valuation purposes. These investments are included in Level 2 and include corporate fixed income, government bonds, and mortgage and asset-backed securities.

Other investments measured at fair value represent funds included on the consolidated balance sheets that are reported using the net asset value practical expedient as prescribed by ASU 2015-07, *Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share*. These amounts are not required to be categorized in the fair value hierarchy. The fair value of these investments is based on the net asset value ("NAV") information provided by the general partner. Fair value is based on the proportionate share of the NAV based on the most recent partners' capital statements received from the general partners, which is generally one quarter prior to the balance sheet date. With the adoption of ASU 2016-01, *Financial Instruments*, certain of UPMC's alternative investments are now utilizing NAV to calculate fair value and are included in other investments in the following tables.

## FAIR VALUE MEASUREMENTS AS OF MARCH 31, 2019

	Level 1	Level 2	Level 3	NAV	Total Carrying Amount
<b>ASSETS</b>					
Fixed income	\$ 961,537	\$ 1,452,547	\$ -	\$ -	\$ 2,414,084
Domestic equity	966,434	18,792	-	-	985,226
International equity	711,827	1,568	-	-	713,395
Public real estate	62,502	-	-	-	62,502
Long/short equity	58,015	15,911	-	-	73,926
Absolute equity	22,773	-	-	-	22,773
Commodities	4,543	-	-	-	4,543
Derivative instruments	-	546	-	-	546
Securities lending collateral	52,242	-	-	-	52,242
Securities on loan	132,892	-	-	-	132,892
Other investments	-	-	-	1,624,319	1,624,319
Total assets measured at fair value on a recurring basis	\$ 2,972,765	\$ 1,489,364	\$ -	\$ 1,624,319	\$ 6,086,448
<b>LIABILITIES</b>					
Derivative instruments	\$ -	\$ (6,193)	\$ -	\$ -	\$ (6,193)
Total liabilities measured at fair value on a recurring basis	\$ -	\$ (6,193)	\$ -	\$ -	\$ (6,193)

# NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

## FAIR VALUE MEASUREMENTS AS OF DECEMBER 31, 2018

	Level 1	Level 2	Level 3	NAV	Total Carrying Amount
<b>ASSETS</b>					
Fixed income	\$ 903,979	\$ 1,461,002	\$ -	\$ -	\$ 2,364,981
Domestic equity	318,851	15,543	-	-	334,394
International equity	408,392	-	-	-	408,392
Public real estate	54,423	-	-	-	54,423
Long/short equity	47,801	23,885	-	-	71,686
Absolute return	21,087	-	-	-	21,087
Commodities	4,515	-	-	-	4,515
Derivative instruments	-	408	-	-	408
Securities on loan	247,777	-	-	-	247,777
Securities lending collateral	171,657	-	-	-	171,657
Other investments	-	-	-	2,408,625	2,408,625
Total assets measured at fair value on a recurring basis	\$ 2,178,482	\$ 1,500,838	\$ -	\$ 2,408,625	\$ 6,087,945
<b>LIABILITIES</b>					
Derivative instruments	\$ -	\$ (7,550)	\$ -	\$ -	\$ (7,550)
Total liabilities measured at fair value on a recurring basis	\$ -	\$ (7,550)	\$ -	\$ -	\$ (7,550)

## 5. FINANCIAL INSTRUMENTS

Substantially all of UPMC's investments in debt and equity securities are classified as trading. This classification requires UPMC to recognize unrealized gains and losses on substantially all of its investments in debt and equity securities as investment revenue in the consolidated statements of operations and changes in net assets. UPMC's investments in debt and equity securities that are donor-restricted assets are designated as nontrading. Unrealized gains and losses on donor-restricted assets are recorded as changes in restricted net assets in the consolidated statements of operations and changes in net assets. Gains and losses on the sales of securities are determined by the average cost method. Realized gains and losses are included in investment revenue in the consolidated statements of operations and changes in net assets.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value using quoted market prices or model-driven valuations. Cash and cash equivalents and investments recorded at fair value aggregate \$6,425,525 and \$6,193,204 at March 31, 2019 and December 31, 2018, respectively.

Investments in limited partnerships that invest in nonmarketable securities are primarily recorded at fair value using the NAV practical expedient if the ownership percentage is less than 5% and are reported using the equity method of accounting if the ownership percentage is greater than 5%. At March 31, 2019 and December 31, 2018, UPMC had \$828,188 and \$663,050 of alternative investments that are not measured at fair value.

UPMC participates in securities lending transactions whereby a portion of its investments are loaned, through its agent, to various parties in return for cash and securities from the parties as collateral for the securities loaned. The amount of cash collateral received under securities lending is reported as an asset and a corresponding payable in the consolidated balance sheet. Total collateral is required to have a market value between 102% and 105% of the market value of securities loaned. As of March 31, 2019, securities loaned, of which UPMC maintains ownership, totaled \$132,892 and total collateral (cash and noncash) received related to the securities loaned was \$141,378.

# NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

## 6. DERIVATIVE INSTRUMENTS

UPMC uses derivative financial instruments to manage exposures on its debt. By using derivatives to manage these risks, UPMC exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivatives. When the fair value of a derivative is positive, the counterparty owes UPMC, which creates credit risk for UPMC. When the fair value of a derivative is negative, UPMC owes the counterparty and, therefore, it does not incur credit risk. UPMC minimizes the credit risk in derivatives by entering into transactions that require the counterparty to post collateral for the benefit of UPMC based on the credit rating of the counterparty and the fair value of the derivative. If UPMC has a derivative in a liability position, the counterparty bears UPMC's credit risk and fair market values could be adjusted downward. Market risk is the effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. Management also mitigates risk through periodic reviews of their derivative positions in the context of their total blended cost of capital.

UPMC maintains interest rate swap programs on certain of its debt in order to manage its interest rate risk. To meet this objective, UPMC entered into various interest rate swap agreements. The notional amount under each interest rate swap agreement is reduced over the term of the respective agreement to correspond with reductions in various outstanding bond series.

The following table summarizes UPMC's interest rate swap agreements:

Swap	Maturity Date	UPMC Pays	UPMC Receives	Notional Amount at	
				Mar 31, 2019	Dec 31, 2018
Floating to fixed	2025	3.6%	68% one-month LIBOR	\$ 79,875	\$ 79,875
Basis	2021	SIFMA Index <sup>1</sup>	67% three-month LIBOR plus .2077%	14,485	21,340
Basis	2037	SIFMA Index <sup>1</sup>	67% three-month LIBOR plus .3217%	46,095	46,095
Floating to fixed	2024	1.413%	67% one-month LIBOR	9,000	-
				\$ 149,455	\$ 147,310

<sup>1</sup> The SIFMA Index is a 7-day high-grade market index comprised of tax-exempt variable rate demand obligations.

UPMC has also entered into equity-related derivative instruments to manage the asset allocation in its investment portfolio. Under the equity index swap agreements UPMC pays a fixed income-like return and receives an equity-like return. The notional amount of these swaps is based upon UPMC's target asset allocation.

# NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

The following table summarizes UPMC's equity swap agreements:

Maturity Date	UPMC Pays	UPMC Receives	Notional Amount at	
			Mar 31, 2019	Dec 31, 2018
2019	One-month LIBOR plus .385%	S&P 500 Total Return Index	-	100,000
			\$ -	\$ 100,000

Pursuant to master netting arrangements, UPMC has the right to offset the fair value of amounts recognized for derivatives, including the right to reclaim or obligation to return cash collateral from/to counterparties. The fair values of the Company's derivative financial instruments are presented below, representing the gross amounts recognized as of March 31, 2019 and December 31, 2018 which are not offset by counterparty or by type of item hedged:

	Mar 31, 2019	Dec 31, 2018
Other assets	\$ 546	\$ 408
Long-term obligations	(6,193)	(7,550)
	\$ (5,647)	\$ (7,142)

The accounting for changes in the fair value (i.e., unrealized gains or losses) of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. None of UPMC's derivatives outstanding as of March 31, 2019 and December 31, 2018 are designated as hedging instruments and as such, changes in fair value are recognized in investing and financing activities as investment revenue in the consolidated statements of operations and changes in net assets. Certain of UPMC's derivatives contain provisions that require UPMC's debt to maintain an investment grade credit rating from certain major credit rating agencies. If UPMC's debt were to fall below investment grade, it would be in violation of these provisions and the counterparties to the derivatives could request payment or demand immediate and ongoing full overnight collateralization on derivatives in net liability positions.

# NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

## 7. PENSION PLANS

UPMC and its subsidiaries maintain defined benefit pension plans (the "Plans"), defined contribution plans and nonqualified pension plans that cover substantially all of UPMC's employees. Benefits under the Plans vary and are generally based upon the employee's earnings and years of participation.

The components of net periodic pension cost for the Plans are as follows:

	Three Months Ended March 31	
	2019	2018
Service cost	\$ 30,268	\$ 29,794
Interest cost	23,161	19,422
Expected return on plan assets	(38,906)	(41,370)
Recognized net actuarial loss	10,350	5,470
Amortization of prior service credit	(1,314)	(1,314)
Net periodic pension cost	\$ 23,559	\$ 12,002

## 8. LEASES

UPMC has operating and finance leases for corporate offices, physician offices and various equipment types, among others. These lease arrangements have remaining lease terms of 1 year to 64 years, some of which include options to extend the leases for several periods, and some of which include options to terminate the leases within 1 year. Balance sheet information related to leases were as follows:

	As of March 31 2019
<b>OPERATING LEASES</b>	
Operating lease right-of-use assets	\$ 1,069,904
Other current liabilities	111,591
Operating lease liabilities	1,012,372
Total operating lease liabilities	\$ 1,123,963
<b>FINANCE LEASES</b>	
Property, plant and equipment, net	\$ 82,328
Other current liabilities	16,021
Other noncurrent liabilities	68,719
Total finance lease liabilities	\$ 84,740

Undiscounted maturities of lease liabilities were as follows:

For the Years Ended December 31	Operating Leases	Finance Leases
2019 (rest of year)	\$ 108,737	\$ 15,290
2020	131,032	17,793
2021	117,340	14,233
2022	108,149	9,594
2023	103,878	3,693
Thereafter	905,095	24,264

# NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS)

## 9. CONTINGENCIES

On October 9, 2012, UPMC received a Civil Investigative Demand (“CID”) from the Department of Justice (“DOJ”) that sought records relating to 40 surgical procedures performed between January 25, 2008 and June 24, 2010. UPMC timely responded to that CID. In November 2013, the DOJ advised UPMC that the CID had been served as part of the DOJ’s investigation of allegations asserted by Relators in a federal qui tam lawsuit filed under seal. On July 27, 2016, the DOJ announced that it had reached an agreement with UPMC to settle certain allegations that UPMC had violated the False Claims Act for approximately \$2,500. UPMC admitted no liability in settling those claims. The DOJ declined to intervene in the remaining allegations of the Relators’ lawsuit, which was also unsealed on July 27, 2016. In their Second Amended Complaint against UPMC and UPP, Inc., Relators allege that UPMC violated the False Claims Act violations, by overpaying physicians and encouraging physicians to perform medically unnecessary procedures. On March 27, 2018, the Court granted UPMC’s motion to dismiss all claims with prejudice. Relators have appealed that Order. UPMC has opposed that appeal. The outcome and ultimate effect on UPMC’s financial statements cannot be determined at this time.

On September 3, 2014, Highmark Inc. and Keystone Health Plan West, Inc. sued UPMC and various UPMC hospitals and physician practices in the Court of Common Pleas of Allegheny County, Pennsylvania, asserting claims for breach of contract and declaratory judgment related to oncology billing. On March 24, 2015, the Court denied UPMC’s preliminary objections to that Complaint. On December 7, 2017, the plaintiffs filed a Second Amended Complaint that dropped the UPMC hospitals as defendants and added a new defendant and new claims against the remaining physician practices. UPMC has answered that complaint and filed counterclaims. Discovery is proceeding. The ultimate outcome and ultimate effect on UPMC’s financial statements cannot be determined at this time.

In May 2015, PCS sued UPMC Health Network, UPMC Benefit Management Services, UPMC Health Benefits, and a PCS competitor in the United States District Court for the Western District of Pennsylvania, asserting four antitrust related claims. In August 2015, PCS filed an amended complaint, removing UPMC Health Network and adding UPMC, a Pennsylvania nonprofit nonstock corporation as a party. Discovery is ongoing. In 2018, the UPMC defendants moved for summary judgment on all PCS claims. On March 27, 2019, the Court granted summary judgment for the UPMC defendants on all counts. PCS has filed a notice of appeal. The outcome and ultimate effect on UPMC’s financial statements cannot be determined at this time.

On February 7, 2019, the Pennsylvania Office of Attorney General filed a Petition to Modify Consent Decree, contending that UPMC has violated “state charities laws” by, among things, refusing to provide full in-network contracts with Highmark Inc. The Attorney General seeks to modify the 2014 Consent Decree that UPMC entered with OAG, the Pennsylvania Insurance Department and Department of Health by obligating UPMC to, among other things: contract with any health care insurer that wants a UPMC contract, require the UPMC Health Plan to contract with any health care provider that wants a UPMC Health Plan contract and replace a majority of its board of directors. The Court bifurcated Count I of the OAG’s petition, which seeks modification of the Consent Decree, from Counts II-IV, which seek other relief. On April 3, 2019, the Court granted UPMC’s motion to dismiss Count I to the extent the OAG seeks to impose any deadlines on UPMC after the Consent Decree ends on June 30, 2019. The OAG has appealed that decision to the Pennsylvania Supreme Court. The outcome and ultimate effect on UPMC’s financial statements cannot be determined at this time.

## 10. SUBSEQUENT EVENTS

Management evaluated events occurring subsequent to March 31, 2019 through May 2, 2019, the date the unaudited interim condensed consolidated financial statements of UPMC were issued. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements.